

**Testimony of José Román Morales, PE
Acting Chairman, Puerto Rico Energy Commission**

**Before the
U.S. Senate Committee on Energy and Natural Resources**

November 14, 2017

Chairman Murkowski, Ranking Member Cantwell, and Members of the Committee:

My name is José Román Morales. I am the Acting Chairman of the Puerto Rico Energy Commission. Thank you for inviting me to appear and for your interest in Puerto Rico's plans for restoring and transforming its electric service. My testimony makes four main points:

1. The Commission is the Commonwealth's institutional expert on electric industry performance.
2. Using its multidisciplinary expertise, the Commission establishes performance standards and competitive pressures, while restoring investor confidence.
3. The Commission's current emphasis is to restore and transform the Island's electric industry, cost-effectively.
4. The Commission's current needs include jurisdictional certainty and sufficient resources.

I. The Commission is the Commonwealth's institutional expert on electric industry performance

For 70 years, the Puerto Rico Electric Power Authority (PREPA) operated as a vertically integrated monopoly—an unregulated monopoly. Dissatisfied with PREPA's performance, the Legislature in 2014 passed Act 57.¹ At the center of Act 57 is the Commission, created and empowered to use performance standards and competitive pressures to transform Puerto Rico's electric industry. The breadth of the Commission's duties is illustrated by these opening provisions:

"[The Commission] shall be an independent government entity in charge of regulating, overseeing, and ensuring compliance with the public policy on energy of the Commonwealth of Puerto Rico."

¹ Puerto Rico Energy and Transformation RELIEF Act, Act 57-2014, 22 L.P.R.A. §1051 et seq.

"The Energy Commission created herein shall be the key component for the faithful and transparent execution of the Energy Reform."

"[T]he Commission --

"shall be able to guarantee the orderly and integrated development of our electrical system, thus ensuring the reliability, efficiency, and transparency thereof, and the provision of electric power services at reasonable prices.

"shall evaluate [PREPA's plans] regarding its obligation to efficiently generate electric power, various operational issues, and the integration of renewable energy, among other mandates.

"shall oversee all types of operations, processes, and mandates pertaining to the efficiency of the energy sector of the Island.

"shall oversee [that] PREPA's debt issues are in the public interest.

"shall approve the electricity rates proposed by PREPA.

"shall require that the prices included in any power purchase agreement, wheeling rate, and interconnection charge are fair and reasonable, consistent with the public interest, and compliant with the parameters established by this Commission....

"shall [...] guarantee that PREPA meets its obligations to bondholders."

In sum, the Commission is the Island's institutional expert, and main decision-maker, on the performance of electricity markets—whether that performance is by a monopoly like PREPA or by competitive providers of generation and other electric services.

II. Using its multidisciplinary expertise, the Commission establishes performance standards and competitive pressures, while restoring investor confidence

The Commission's employees and consultants span the professional disciplines of engineering, economics, finance, accounting, management, and law. Using these disciplines, we establish principles that are then embodied in our orders.

A. Principles

The purpose is performance. When establishing standards for utility monopolies, the goal is to induce performance comparable to what effective competition would produce: reliable, innovative service at reasonable cost. When injecting competition, the goal is to attract and reward the most cost-effective entities. The Commission's task is to envision the products and services that best serve customers, then design and oversee the market

structures and inducements most likely to produce that mix of products and services cost-effectively.

The key criterion is economic efficiency. A utility cost is reasonable if, and only if, the Commission determines it to be the least-cost alternative among all feasible alternatives. The Commission aims to allocate costs to cost-causers and benefits to benefit-creators. These standards induce performance that is economically efficient.

Good decision-making requires gathering the best facts. The Commission uses procedures that elicit fact-based presentations from diverse experts. We subject those presentations to detailed discovery and close questioning, all performed in public. We vary procedural formality as resources and time considerations demand.

The Commission's effectiveness depends on its independence. The Commission is an expert agency that makes decisions based on facts and logic—not political pressures or ideological beliefs.

At bottom: Facts and expertise, applied openly, bounded by statutory and constitutional principles and subject to judicial review, are the ingredients the Commission uses to induce cost-effective performance.

B. Key Commission Actions Pre-Hurricanes Irma and María

The foregoing principles are evident in the Commission's many orders. Four are key.

Transition Charge: In June 2016, the Commission approved, under Act 4-2016, 22 L.P.R.A. §1071 et seq., a mechanism designed to reduce the costs to customers of PREPA's repayments to certain bondholders.² In light of the agreement of those bondholders to reduce, and defer payment of, a portion of PREPA's debt obligations, the Commission approved a Commonwealth-backed "Transition Charge." Although the Transition Charge order has been superseded by events,³ its effect, once the magnitude of the Charge was calculated and approved, would have been to reduce investor uncertainty by moving dollars from ratepayers directly to the bondholders.

Integrated resource plan: In September 2016, the Commission approved an integrated resource plan (IRP) for PREPA.⁴ The IRP order approved, among other things: (a)

² Restructuring Order, Case No. CEPR-AP-2016-0001, June 21, 2016. Available at: <http://energia.pr.gov/wp-content/uploads/2016/06/21-junio-2016-Restructuring-Order-English-1.pdf>.

³ The Transition Charge was tied to the then-existing Restructuring Support Agreement (RSA). The FOMB initiation of the Title III proceeding under PROMESA resulted in the RSA not being extended.

⁴ Final Resolution and Order on the First Integrated Resource Plan of the Puerto Rico Electric Power Authority, Case No. CEPR-AP-2015-0001, September 29, 2016. Available at: <http://energia.pr.gov/wp-content/uploads/2016/09/23-sept-2016-Final-Resolution-and-Order-IRP-CEPR-AP-2015-0002.pdf>.

temporary, limited spending on continued development of the Aguirre Offshore Gas Port; (b) the permitting, maintenance, development, and retirement of various fossil fuel units; and (c) certain investments in transmission and distribution, as necessary for system stability and operability. The IRP order also required a detailed audit of renewable energy contracts, a competitive bidding process for certain new renewable energy projects, and certain investments in energy efficiency.

PREPA's performance: In November 2016, the Commission began a far-reaching inquiry into PREPA's overall performance, gathering information on PREPA's performance so as to develop metrics and consequences for all aspects of its operations.⁵

Rate decision: In January 2017, the Commission issued the first-ever order in which PREPA's \$3.5 billion in annual costs were reviewed, and rates established, by an independent body of experts.⁶ While granting PREPA nearly all the dollars it requested (for both capital and operating expenditures), the order detailed the extent of system deterioration; the history of counterproductive political involvement in financial, operational, and rate deficiencies; and the absence of discipline in PREPA's budgeting and spending.

In the rate order's crucial Part Four, the Commission addressed the problem of PREPA's imprudent costs. The Commission explained that because PREPA is a non-profit, government-owned entity, conventional disincentives used to prevent utilities from taking on imprudent costs—namely, requiring their absorption by shareholders rather than imposing them on ratepayers—are unavailable because a non-profit company has no private shareholders. In the non-profit context, the utility will have insufficient revenues to operate unless all costs are recovered from ratepayers. Given this constraint, the only way to protect ratepayers from imprudent costs is to prevent PREPA from incurring them to begin with. The Commission therefore required PREPA to submit an annual budget before spending its money. That way, the Commission could prevent imprudent expenditures before they are incurred. (PREPA had proposed an annual "true-up" process that amounted to "We spend it, we tell you about it, you make ratepayers pay for it"—the very absence of accountability that Act 57 was enacted to fix.)

Other orders: The Commission has approved the format for a simplified customer bill so that customers better understand the bases for their charges.⁷ These efforts and others are summarized in the Appendix to this testimony.

⁵ Notice of Investigation to Identify Opportunities to Improve Performance of the Puerto Rico Electric Power Authority, Case No. CEPR-IN-2016-0002, November 16, 2016. Available at: <http://energia.pr.gov/wp-content/uploads/2016/11/15-nov-2016-Notice-of-Investigation-AEE-CEPR-IN-2016-0002.pdf>.

⁶ Final Resolution and Order, Case No. CEPR-AP-2015-0001, January 10, 2017. Available at: <http://energia.pr.gov/wp-content/uploads/2017/01/Final-Resolution-and-Order.pdf>.

⁷ Final Resolution and Order, Case No. CEPR-AP-2016-0002. Available at: <http://energia.pr.gov/wp-content/uploads/2017/11/Final-Resolution-and-Order-CEPR-AP-2016-0002.pdf>.

All these activities—conducting integrated resource planning, establishing special charges to satisfy bondholder concerns, setting rates, auditing performance—are the central purposes of independent oversight of utilities, as carried out by commissions throughout the Mainland and, in fact, the world. The Puerto Rico Energy Commission is the institution authorized to carry out, and expertly capable of carrying out, these activities in Puerto Rico.

III. The Commission's current emphasis: Restore and transform, cost-effectively

In the last three weeks, the Commission has issued three orders that address restoration and transformation.

Investigation of collapse and solutions: Three weeks ago, the Commission opened a proceeding to assess the physical state of PREPA's system after Hurricane María.⁸ The proceeding will (a) identify the system's vulnerabilities that contributed to its collapse; and (b) identify short-, medium- and long-term actions, by PREPA and the Commission, that will produce an electric system that is modern, flexible, resilient, and capable of supplying electric service reliably and at just and reasonable prices.

Analysis of options for microgrids and distributed generation: PREPA's difficulties restoring service show the need to adopt and implement alternatives that allow greater resilience and faster restoration. Distributed generation technologies, such as microgrids, have the potential for restoring power to unserved areas and providing stability to recently reconnected areas. In this proceeding, the Commission will assess alternative ways to promote these technologies, increase private participation in restoration efforts, and reduce dependence on centralized generation—all with the goal of enabling us to respond to future emergencies more quickly and cost-effectively.⁹

Disciplining the PREPA's contracting process: Prior Commission inquiries have produced unambiguous, concrete examples of defective contracting policies and poor project management. Correcting these defects is crucial to PREPA's ability to attract future financing, while lowering its rates so that the Commonwealth's economic development efforts can succeed. But the Commission's corrective measures have been resisted by PREPA, and challenged in court by PREPA and the Financial Oversight and Management Board (FOMB). In this new order, the Commission has established rigorous oversight measures, which include detailed expense and labor reports for each contractor, so that the Commission can prevent waste before the fact.¹⁰

In these and other proceedings Commission will be focusing on the following areas:

⁸ Resolution, Case No. CEPR-IN-2017-0002, October 27, 2017. Available at: <http://energia.pr.gov/wp-content/uploads/2017/11/Investigación-Post-María-CEPR-eng-.pdf>.

⁹ See Case No. CEPR-IN-2017-0002. Available at: <http://energia.pr.gov/expedientes/?docket=cepr-in-2017-0002>.

¹⁰ *Id.* Available at: <http://energia.pr.gov/expedientes/?docket=cepr-in-2017-0002>.

PREPA's spending, cost recovery and rate-setting: Budgets, revenue requirement, rate design, and procedures for updating and reconciling those items.

PREPA's internal operations: Performance metrics, reporting procedures and enforcement methods; independent monitors to oversee restoration contracting and work; standards for restoration plans and maintenance plans; power plant efficiency standards; criteria for hiring of contractors; disaster preparation and restoration plan (for future events); and plans for workforce recruitment, development, and compensation.

PREPA's finances: Financing plans, debt restructuring, debt issuances, and approvals of Transition Charge mechanisms.

PREPA's customer relations: Bill format, customer complaint procedures, and customer education programs to produce efficient consumption under both monopoly and competitive market structures.

The Island's supply and demand resources: Reliability parameters, integrated resource plans (including the mix of renewable and non-renewable sources and "ancillary services"); near-term action plans; specifications for requests for proposals and competitive bidding procedures for power supply, energy efficiency, and demand resources; designating appropriate types of customer meters; approval of contracts for supply and demand resources and infrastructure modernization; and siting approvals.

The Island's market structure transformation: Identify strengths and weaknesses of alternative market structures (monopoly vs. competition) for various products and services; implement competition for competitive services; consider any transfer of PREPA assets or business functions to other entities; and determine the appropriate roles for distributed generation, net-metered resources, community solar, microgrids, and other venues for sale of energy by third-parties to end-use customers; along with interconnection terms, compensation, payments for transportation, locational choices, and other parameters.

IV. The Commission's needs: Jurisdictional certainty and sufficient resources

Act 57, passed in 2014, makes the Commission the Commonwealth's policy leader on our electricity future. I have explained how we intend to lead: our legal duties, our principles, our past actions, our current actions, our plans. To continue this progress, to succeed, the Commission needs two things: jurisdictional certainty and sufficient resources.

A. Jurisdictional certainty

The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) has several provisions recognizing the Commission's centrality to Puerto Rico's electricity future. Most importantly, section 503(b)(1)(D) provides that if the Commission determines, per a PROMESA-established deadline, that an "Energy Project will adversely affect an approved Integrated Resource Plan, then the Energy Commission shall provide the reasons

for such determination and the Energy Project shall be ineligible for Critical Project designation[...]" Ensuring such projects pass through a Commission screen is essential to establishing and maintaining competitive accountability and cost-effectiveness.

At the same time, a problem has arisen. PROMESA section 4 says: "The provisions of this Act shall prevail over any general or specific provisions of territory law, State law, or regulation that is inconsistent with this Act." We appreciate the purpose underlying this sentence: The FOMB, charged with "provid[ing] a method for a covered territory to achieve fiscal responsibility and access to the capital markets" (Section 101(a)), must be able to achieve its purpose without obstacles. The problem is in the practical application of this principle. The Commission is the Commonwealth's electricity expert. Its powers and obligations are expansive. It was here before the FOMB arrived and will be here after the FOMB departs. In addressing PREPA's performance and in transforming Puerto Rico's electricity markets, both entities have essential roles to play. We must find a way for each entity to use its powers and skills in a way that supports and reinforces the other. Unnecessary conflict, turf-protection and failure to coordinate will lead only to expensive litigation, policy delays and loss of public trust.

Earlier in this testimony, I described how the Commission will discipline PREPA's expenditures (so as to prevent careless service engagements, as recently experienced) by reviewing its budgets in advance of spending. PREPA has opposed this requirement. Surprisingly, its opposition was supported by the FOMB in a submission made to the federal court with jurisdiction over the Commonwealth's debt situation. You may also be aware that FOMB has asked the federal court to approve its appointment of a Chief Transformation Officer to run PREPA. We have asked the federal court to avoid inadvertently finding that such an appointment preempts the Commission's authority. We also asked the court to direct the lawyers for FOMB and the Commission to create protocols that preserve each entity's strengths, so that conflict and litigation can be avoided. While the FOMB's legal staff has expressed willingness to communicate with the Commission, little effort has been made on their part to achieve meaningful coordination which leads to productive results. We remain hopeful that future actions will yield concrete results.

The Commission recognizes the overlap between its budget review requirements—necessitated by the Commission's statutory obligation to protect ratepayers from imprudent costs and make rates that are just and reasonable—and the FOMB's need to review and approve budgets. There are ready ways to coordinate these two entities' efforts so that each strengthens the other while avoiding duplication of effort. The Commission's and FOMB's purposes aim for the same results: financial solvency, attraction of capital, operational discipline, prudent expenditures, and responsive customer service. The Commission therefore has notified FOMB's representatives of this need, prepared a detailed work plan for producing coordination solutions, and assumes that FOMB will reciprocate productively. I also assume that such coordination is the wish of this Committee.

B. Sufficient resources

The Commission's annual resources are currently limited to the statutory level of \$5.8 million, supplemented by approximately \$1.25 million that we collect through fees. This amount was never well-aligned with the Commission's responsibilities since its inception; it is now unrealistically small given the complex questions we now need to address, as my testimony has explained. Should Congress be willing to supplement the Commission's budget, the needs fall into four main areas: (a) establishment of regulatory procedures for the immediate recovery period; (b) monitoring (in part via independent auditors) of PREPA's restoration process; (c) audits of PREPA's existing system, resources, and assets; and (d) proceedings to transform Puerto Rico's electric sector.

Conclusion

In this testimony, I have sought to explain the Commission's obligations and plans for restoring our electric service and transforming our electric industry. The need for an independent entity, free of politics and focused on merits, with the single-minded goal of bringing cost-effectiveness and competitive rigor to the Commonwealth's most important infrastructural industry, could never be greater.

Chairman Murkowski, Ranking Member Cantwell and Members of the Committee, thank you for this opportunity to testify. I look forward to your questions.

Appendix

SUBJECT	DOCKET NUMBER	DESCRIPTION
Rates	CEPR-AP-2015-0001	The rate case is an examination and subsequent ruling on PREPA's first petition for permanent rates before an independent regulatory body. In its review, the Commission sought to obtain the most thorough picture of PREPA's finances and costs, so as to establish a rate structure consistent with both PREPA's current financial and operational situation, and to carry out the Commission's and PREPA's duties to further Puerto Rico's energy public policy.
Provisional Rate Order	CEPR-AP-2015-0001	As part of its rate review petition, PREPA included a petition for provisional or temporary rates to be applied to its customers for the duration of the rate case before the Commission and until the application of the final set of rates approved by the Commission.
Revenue Allocation & Rate Design	CEPR-IN-2017-0001	The rate case established PREPA's total revenue need but, because of the tight statutory deadline, did not address major questions about how to allocate PREPA's revenue needs among customer groups (revenue allocation); and for each customer, between the fixed charge and the variable charge (rate design). This separate investigation is intended to complete that work. It includes dealing with the adequacy and completeness of the information and data used by PREPA to determine revenue allocation and rate design. In this investigation, the Commission seeks to determine and gather the information necessary to determine the revenue allocations and rate designs that are consistent with economic efficiency, and just and reasonable rates.
New Transparent Bill	CEPR-AP-2016-0002	Parallel to the rate proceeding, the Commission carried out a proceeding to establish the content and format of PREPA's "New Transparent Bill" pursuant to §6B(C) of Act No. 83. PREPA's new transparent bill, which will enter into force along with PREPA's new rates, will itemize specific cost categories, such as "subsidies," contribution in lieu of taxes, the Transition Charge, and fuel costs; so that customers will have clearer picture of the key components of their monthly electric service bill.
Transition Charge	CEPR-AP-2016-0001	Through this proceeding, the Commission enabled the PREPA Revitalization Corporation ("PREPARC") to set in motion a series of financial transactions with participating PREPA bondholders by which PREPA's overall "legacy" debt is reduced, in exchange for the establishment of a "Transition Charge", which will be billed to customers along with their monthly electricity bills in order to cover the repayment of PREPA's legacy debt. Under Act 4-2016, the amount will be determined by a Commission-approved "Adjustment Mechanism". The Commission's final decision modified PREPARC's proposed charge by making it a

		volume-based charge rather than a fixed charge, as well as establishing key exceptions for certain net metering and fixed block customers, upholding the provisions of Act 114-2007 and Act 22-2016.
Integrated Resource Plan (IRP)	CEPR-AP-2015-0002	In an Integrated Resource Plan (IRP) proceeding, required periodically by Act 57, PREPA submits –for the Commission's evaluation and approval– a comprehensive, long-term plan for the use of all existing and future resources PREPA intends to deploy in order to meet the demand for electric service, over a 20-year planning period. The IRP includes an assessment of the planning environment, a detailed study of a range of future load forecasts, existing generation and demand resources, current investments in conservation technology, existing transmission and distribution facilities, and the relevant forecasts and scenario analyses in support of the selected plan.
PREPA's Performance	CEPR-IN-2016-0002	This proceeding is a far-reaching inquiry into PREPA's overall performance as an electric utility. Informed by its IRP and rate rulings, its overall regulatory body of work, as well as ample stakeholder input, the Commission is in the process of gathering the necessary information with regard to PREPA's current performance, in order to regulate a set of performance metrics for PREPA across several key indicators.
Aguirre Site Economic Analysis	CEPR-AP-2017-0001	Stemming from key questions raised by the Commission and stakeholders during the IRP proceeding, the Commission seeks to ascertain whether PREPA's reliance on the Aguirre Offshore Gas Port (AOGP) project as part of its proposed IRP is economically beneficial to PREPA's ratepayers.
Sunnova Investigation	CEPR-IN-2016-0001	This investigation responds to a petition by the Independent Consumer Protection Office, which brought to the Commission's attention several concerns raised by a number of customers of Sunnova Energy Corporation, regarding their dissatisfaction with Sunnova's services pursuant to its long-term power purchase contracts for rooftop solar. Within this investigation, the Commission has issued a series of information requirements to Sunnova in order to better understand its business model and determine its place within the broader regulatory framework for electric service providers other than PREPA.
PV Properties v. PREPA	CEPR-QR-2017-0001	In this proceeding, the Commission addresses a complaint by PV Properties, Inc., who alleges that PREPA is in violation of the provisions of Act 82-2010 with regard to the latter's refusal to purchase the Renewable Energy Certificates (RECs) that the former has offered for sale. This complaint raises, among others, questions concerning the nature and scope of Act 82-2010 in shaping and creating a market for RECs in Puerto Rico, the role of the Commission in enforcing said Act's provisions on this matter, and the interaction between the RECs market and PREPA's Renewable Portfolio Standard (RPS) obligations.

<p>Hurricane María Investigation</p>	<p>CEPR-IN-2017-0002</p>	<p>The Commission initiated this investigation in order to assess the overall state of Puerto Rico's electric system after Hurricane María's strike on September 20, 2017. With the information gathered in this proceeding, the Commission will determine the appropriate short-term regulatory actions necessary to facilitate the restoration of Puerto Rico's electric power system and, more importantly, the longer-term actions that will enable its reconstruction into a more robust, efficient, and resilient system.</p>
<p>Net Metering Regulation Standards</p>	<p>CEPR-MI-2014-0001</p>	<p>Pursuant to its mandate under Act 114-2007, the Commission established the standards by which PREPA must abide in regulating the interconnection of net metered customers into its grid. In the face of questions concerning PREPA's compliance with its statutory obligations, the Commission's orders in this docket have enforced and ensured PREPA's compliance with Puerto Rico's public policy promoting net metering and distributed generation.</p>
<p>Customer Bill Disputes</p>	<p>Multiple</p>	<p>The Commission presides over disputes that customers have with charges on electric service bills, as well as the consumer protections the law affords consumers. The Commission's process includes an initial informal procedure before the electric service company (pursuant to the Commission's regulations), and a latter formal review procedure before the Commission.</p>